

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47293; File No. SR-ISE-2002-19]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change by International Securities Exchange, Inc., Relating to Rules Governing the Intermarket Linkage, and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 Thereto

January 31, 2003.

#### I. Introduction

On September 24, 2002, the International Securities Exchange, Inc. ("ISE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),<sup>1</sup> and rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to adopt new Chapter 19 of its rules, governing the operation of the intermarket linkage (the "Linkage"). The proposed rule change was published for comment in the **Federal Register** on December 26, 2002.<sup>3</sup> The Commission received no comments on the proposed rule change. On January 28, 2003, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>4</sup> This order approves the proposed rule change, provides notice of filing of Amendment No. 1 and grants accelerated approval to Amendment No. 1.

#### II. Description of Proposal

In general, the proposed rules contain relevant definitions, establish the conditions pursuant to which market makers may enter Linkage orders, impose obligations on the Exchange regarding how it must process incoming Linkage orders, and establish a general standard that members should avoid

trade-throughs.<sup>5</sup> The proposed rules establish potential regulatory liability for members who engage in a pattern or practice of trading through other exchanges, whether or not the exchanges traded through participate in the Linkage, provide procedures to unlock and uncross markets, and codify the "80/20 Test" contained in section 8(b)(iii) of the Plan for the Purpose of Creating and Operating an Intermarket Options Linkage (the "Plan"),<sup>6</sup> which provides that a market maker on an Exchange would be restricted from sending principal orders (other than P/A orders, which reflect unexecuted customer orders) through the Linkage if the market maker effects less than 80 percent of specified order flow on the Exchange. The proposed rule change also establishes a fee, which will apply to Principal Orders and Principal Acting as Agent Orders. These fees are the same fees applicable to ISE market makers.

#### III. Discussion

The Commission has reviewed the ISE's proposed rule change and finds that the proposal is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange,<sup>7</sup> and with the requirements of section 6(b).<sup>8</sup> In particular the Commission finds that the proposed rule change is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest in accordance with section 6(b)(5) of the Act.<sup>9</sup> The Commission also finds that the proposed fee change is consistent with section 6(b)(4) of the Act<sup>10</sup> in that it represents an equitable allocation of

reasonable dues, fees and other charges among its members and other persons using its facilities.

The Commission believes that the rules proposed by the ISE will adequately govern the operation of the Linkage as envisioned in the Plan. The Commission believes that these rules will help to ensure that the Linkage is operated fairly and effectively, in accordance with the principles of the Act and the Plan.

The Commission also finds good cause for approving proposed Amendment No. 1 prior to the 30th day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No. 1 proposes several changes to the Exchange's original proposal that are designed to conform the Exchange's rules governing linkage more closely to the Plan. The provisions of the Plan have already been subject to notice and comment, and have been approved by the Commission. The changes proposed in Amendment No. 1 do not raise any novel regulatory issues, and therefore, it is appropriate for the Commission to accelerate approval of Amendment No. 1.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 1 to the proposed rule change, including whether Amendment No. 1 is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to Amendment No. 1 between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-ISE-2002-19 and should be submitted by February 27, 2003.

#### V. Conclusion

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>11</sup> that the proposed rule change (SR-ISE-2002-19), be, and hereby is, approved, and that Amendment No. 1 to the proposed

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 47029 (December 18, 2002), 67 FR 78834.

<sup>4</sup> See letter from Michael J. Simon, Senior Vice President and General Counsel, ISE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated January 27, 2003 ("Amendment No. 1"). In Amendment No. 1, the Exchange proposed to amend: (1) The definition of "Linkage Order" contained in ISE rule 1900 to state that such orders are immediate or cancel orders; (2) ISE rule 1901 to clarify when members may send linkage orders when markets are non-firm; (3) ISE rule 1901 to include a provision regarding mitigation of damages; (4) ISE rule 1902 to clarify language regarding liability for trade-throughs at the end of the trading day and to request approval of this provision only for a one-year pilot period; and (5) ISE rule 1902 to clarify that members may not engage in a pattern or practice of trading through.

<sup>5</sup> Trade-throughs occur when broker-dealers execute customer orders on one exchange at prices inferior to another exchange's disseminated quote.

<sup>6</sup> Approved by the Commission in Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000), as subsequently amended. See Securities Exchange Act Release No. 44482 (June 27, 2001), 66 FR 35470 (July 5, 2001) ("Initial Amendment Order") and Securities Exchange Act Release No. 46001 (May 30, 2002), 67 FR 38687 (June 5, 2002); 47274 (January 29, 2003); and 47298 (January 31, 2003).

<sup>7</sup> In approving this rule proposal, the Commission notes that it has also considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>8</sup> 15 U.S.C. 78f(b).

<sup>9</sup> 15 U.S.C. 78f(b)(5).

<sup>10</sup> 15 U.S.C. 78f(b)(4).

<sup>11</sup> 15 U.S.C. 78s(b)(2).

rule change be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47302; File No. SR-NASD-2002-174]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change by National Association of Securities Dealers, Inc., Relating to Increasing Dissemination of Debt Securities Transaction Information Under the TRACE Rules

January 31, 2003.

#### I. Introduction

On December 6, 2002, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder<sup>2</sup> to amend the Rule 6200 Series of the Rules of NASD, which provides for the reporting and dissemination of transaction information in eligible corporate debt securities ("TRACE Rules"). The proposed rule change would provide additional transparency in the corporate bond market by increasing the categories of TRACE-eligible securities for which transaction information is required to be disseminated. NASD amended the proposed rule change on December 18, 2002.<sup>3</sup> Notice of the proposed rule change and Amendment No. 1 thereto was published for comment in the *Federal Register* on December 27, 2002.<sup>4</sup> The Commission received two

comment letters regarding the proposal.<sup>5</sup>

This order approves the proposed rule change as amended by Amendment No. 1.

#### II. Background

On January 23, 2001, the Commission approved the TRACE Rules to establish a corporate bond trade reporting and transaction dissemination facility and to eliminate Nasdaq's Fixed Income Pricing System ("FIPS").<sup>6</sup> Subsequently, on March 5, 2001, the Commission approved amendments to the TRACE Rules requiring trade reports in transactions between two NASD members to be filed by each member.<sup>7</sup> In addition, on January 3, 2002, the Commission issued a notice stating that certain other amendments to the TRACE Rules had become effective on filing.<sup>8</sup> On June 28, 2002, the Commission approved a proposed rule change to establish fees for the use of TRACE on a pilot basis for six months,<sup>9</sup> and also approved proposed amendments to the TRACE Rules to make technical changes to the TRACE Rules and clarify certain provisions of those Rules prior to implementation of TRACE.<sup>10</sup>

The TRACE Rules became effective on July 1, 2002. On that day, members began to report transactions in TRACE-eligible securities, and the TRACE system began the dissemination of certain reported information. On November 22, 2002, the Commission issued a notice stating that NASD was reducing certain TRACE fees for the fourth quarter of 2002.<sup>11</sup> On December 19, 2002, the Commission issued a notice stating that an extension of the

<sup>5</sup> See letter from John M. Ramsay, Vice President and Senior Regulatory Counsel, The Bond Market Association ("TBMA"), to Jonathan G. Katz, Secretary, SEC, dated January 16, 2003 ("TBMA's Letter") and letter from Rene L. Robert, President and CEO, Advantage Data, Inc., to Secretary, SEC, dated January 10, 2003 ("Advantage Data's Letter"). TBMA's Letter and Advantage Data's Letter are described in Section IV, *infra*.

<sup>6</sup> See Securities Exchange Act Release No. 43873 (January 23, 2001), 66 FR 8131 (January 29, 2001) (File No. SR-NASD-1999-65). FIPS, which was operated by Nasdaq, collected transaction and quotation information on domestic, registered, non-convertible high-yield corporate bonds.

<sup>7</sup> See Securities Exchange Act Release No. 44039 (March 5, 2001), 66 FR 14234 (March 9, 2001) (File No. SR-NASD-2001-04).

<sup>8</sup> See Securities Exchange Act Release No. 45229 (January 3, 2002), 67 FR 1255 (January 9, 2002) (File No. SR-NASD-2001-91).

<sup>9</sup> See Securities Exchange Act Release No. 46145 (June 28, 2002), 67 FR 44911 (July 5, 2002) (File No. SR-NASD-2002-63).

<sup>10</sup> See Securities Exchange Act Release No. 46144 (June 28, 2002), 67 FR 44907 (July 5, 2002) (File No. SR-NASD-2002-46).

<sup>11</sup> See Securities Exchange Act Release No. 46893 (November 22, 2002), 67 FR 72008 (December 3, 2002) (SR-NASD-2002-167).

pilot program for TRACE fees to February 28, 2002 and a modification of the pilot effective January 1, 2003 had become effective on filing.<sup>12</sup>

#### III. Description of the Proposal

NASD is proposing to amend: (1) NASD Rule 6250 to provide for the dissemination of transaction information on additional Investment Grade TRACE-eligible securities under the NASD Rule 6200 Series (also known as the Trade Reporting and Compliance Engine ("TRACE") Rules);<sup>13</sup> (2) NASD Rule 6210(e) to include the term "customer" in the defined term, "party to the transaction"; (3) NASD Rule 6260 to make minor clarifications; and, (4) in the provisions referenced in (1) through (3) above, to delete the term "Association" and to replace it with "NASD." These amendments are discussed in greater detail in the Commission's notice soliciting public comment on this proposal.<sup>14</sup>

In Amendment No. 1, NASD deleted proposed changes to NASD Rule 6230 and NASD Rule 9610(a) that would have allowed members to request exemptive relief from NASD Rule 6230.

#### IV. Discussion

After careful consideration, the Commission finds that the proposed rule change, as amended by Amendment No. 1, is consistent with the Act and the rules and regulations promulgated thereunder applicable to a registered securities association and, in particular, with the requirements of Section 15A(b)(6).<sup>15</sup> Specifically, the Commission finds that approval of the proposed rule change is consistent with Section 15A(b)(6) of the Act in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and in general, to protect investors and the public interest.<sup>16</sup>

The Commission believes that the proposed rule change will substantially increase the amount of information available to the public and market participants about the corporate debt markets and will clarify other TRACE Rule provisions. NASD stated that if the proposed rule change is approved, over 4,000 TRACE-eligible securities will be

<sup>12</sup> See Securities Exchange Act Release No. 47056 (December 19, 2002), 67 FR 79205 (December 27, 2002) (File No. SR-NASD-2002-176).

<sup>13</sup> The terms "Investment Grade" and "TRACE-eligible security" are defined in TRACE Rule 6210, Definitions, in paragraphs (h) and (a), respectively.

<sup>14</sup> See *supra*, note 4.

<sup>15</sup> 15 U.S.C. 78o-3(b)(6).

<sup>16</sup> In approving this proposed rule change, the Commission has considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>12</sup> 17 CFR 200.30-3(a)(12).

<sup>13</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See letter from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, to Katharine A. England, Assistant Director, Division of Market Regulation, SEC, dated December 18, 2002, and enclosures ("Amendment No. 1"). In Amendment No. 1, NASD deleted proposed changes to NASD Rule 6230 and NASD Rule 9610(a) that would have allowed members to request exemptive relief from NASD Rule 6230.

<sup>4</sup> See Securities Exchange Act Release No. 47057 (December 19, 2002), 67 FR 79210.